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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 137

CHARLES PETTIT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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Of Counsel.

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SUPREME COURT OF THE UNITED STATES

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No. 137

CHARLES PETTIT,

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COMMISSIONER OF INTERNAL REVENUE.

PETITION.

To the Honorable, the Supreme Court of the United States:

Comes now Charles Pettit, hereinafter styled petitioner, and, applying for writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit, respectfully shows:

Statement of the Case.

The case involves the applicability of the capital gains provisions [1] of the Revenue Acts of 1934 and 1936 to the

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[1] Section 117. *Capital Gains and Losses.*

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than one year;

80 per centum if the capital asset has been held for more than one year but not more than two years;

proceeds of the sales of certain crude oil received by petitioner during the years 1934, 1935 and 1936 (R. 46 & 47). Petitioner claims the provisions apply (R. 54); the Commissioner denies that they do (R. 55).

Prior to the years involved, petitioner had acquired, by investment (B. T. A. Syllabus, R. 45), thirty-one so-called oil payment contracts. (Copies of the contracts were introduced before the Board as Exhibits 1 to 31, inclusive (R. 48), and each contained a particular description of the lands in the East Texas Oil Field under which the particular oil lay.) In these proceedings some of these contracts are referred to as barrel contracts, and the others as dollar contracts. Under eight of the barrel contracts, Pettit's vendors granted, sold and conveyed to him and agreed to deliver if, as and when produced, a definite number of barrels of merchantable pipe line crude oil from a specified fractional part of the total production from the specified premises. In the case of the other barrel contract, Pettit in 1931 sold his interest in an oil lease for $5,000.00 in cash and reserved 210,000 barrels of oil in place (R. 49). Five of the dollar contracts were acquired by Pettit from the owners of the working interests (i. e., the lessees) of certain oil and gas leases, and those owners sold and conveyed to him the proceeds from the sale of certain specified frac-

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60 per centum if the capital asset has been held for more than two years but not more than five years;

40 per centum if the capital asset has been held for more than five years but not more than ten years;

30 per centum if the capital asset has been held for more than ten years.

(b) *Definition of Capital Assets.*—For the purposes of this title "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

tional parts of the oil and gas in and under and which should be produced, saved and sold from the specified premises until he had received a certain fixed sum of money from the sale of the oil. In eleven of the dollar contracts, Pettit purchased or otherwise acquired from others their interests, or a portion of their interests, in various oil payment contracts (R. 48). In two of the dollar contracts, Pettit has been the owner or part owner of leases and had assigned them, retaining the right to receive a certain sum of money from a specified fraction of the oil produced and saved from the leases (R. 49).

All of the contracts are alike in that there is no personal obligation to pay Pettit the specified number of barrels of oil or amounts of money out of oil, and he must look to the oil and to the oil only for the return of his capital investment (R. 49).

Each of the contracts contained provisions similar to the following:

> "for and in consideration of the sum of $10.00 and other good and valuable consideration * * * granted, sold and conveyed and hereby agrees to deliver unto the buyer if, as and when produced and saved from the aforesaid tracts of land (the specified number of) barrels of merchantable pipe line crude oil" etc.
>
> "This conveyance is intended to have all the effect of a deed to the said oil hereby conveyed to the buyer out of (specified fraction) of all of the oil produced and saved from the aforesaid lease herein provided, and any pipe line company or other purchasers of oil from said lease shall so treat this agreement and it shall not be necessary for the seller to execute to the buyer any further conveyance or other instruments to enable the buyer to receive full performance hereof" (R. 49).

though not all used the identical language (R. 50). Neither party contends that there are any differences in substance

in this respect in the several contracts and conveyances (R. 50).

The leasehold estates to which these contracts were applicable were developed without cost to Pettit and he had nothing whatever to do with and paid no part of the cost of drilling the wells or the production of the oil (R. 51). The operators of the various leases arranged with pipe line companies to purchase and run the oil, and Pettit in each instance executed what is known in the oil industry as a "division order" to the purchasing pipe line company (R. 51). At the time of the Board's decision, the wells out of which Pettit's oil was produced were permitted to produce oil five days a week, with a maximum production of twenty-two and a fraction barrels a day. Under the restriction in force at the time, from three to thirty years would be required for him to receive the number of barrels of oil or the number of dollars out of oil to which he was entitled (R. 51). The oil produced is accumulated in storage tanks and at irregular intervals, depending upon the amount of storage, the oil is run from the tanks into the pipe lines belonging to the purchasing companies. Pettit has nothing to do with the running of the oil. The pipe line companies purchasing the oil pay him once a month for the amount he is entitled to receive (R. 53).

The Commissioner allowed petitioner to deduct from this income, cost depletion or the statutory percentage depletion (27½%), whichever was greater (R. 55). He held that the balance was taxable as ordinary income, wherefore, he determined the following deficiencies against petitioner:

1934	$4,552.98
1935	2,316.07
1936	5,523.44

(R. 46). Petitioner agreed that he was entitled to the depletion allowances, but insisted that the sales of his oil were

sales of capital assets within the meaning of Section 117 and that he was entitled to use the applicable percentages of the section in computing the income (R. 54), which would result in refunds and not deficiencies (R. 47).

Petitioner and his wife, Bertie Pettit, residents of Texas, filed separate income tax returns for the years involved. Their books were kept and their returns rendered on a basis of cash receipts and disbursements, and all of their income and all of their allowable deductions were community income and deductions (R. 48).

Petitioner's wife has also filed a petition for writ of certiorari.

Statement as to Jurisdiction.

The Board of Tax Appeals agreed with the Commissioner (R. 60), and on March 22, 1941, the Circuit Court of Appeals for the Fifth Circuit affirmed the Board's decision (R. 76). Jurisdiction of this case is conferred upon the Supreme Court by I. R. C., Section 1141(a) and 28 U. S. C. A., Section 347. The opinion of the Circuit Court of Appeals is set out at page 73 of the Record.

Questions Presented.

Was the income in question gain from the sale or exchange of capital assets within the definitions of the Revenue Acts of 1934 and 1936, or was it ordinary income? To put the question generally: Does the owner of definite quantities of oil in place in the earth, acquired by purchase as an investment through so-called oil payment contracts, which vested him with present title and made provision for the future delivery of the oil above ground, and who receives the proceeds from the sale of the oil after it is lifted from the earth, but had nothing to do with the lifting, receive ordinary income, or gain from the sale of capital assets, under the capital gains provisions of the Revenue Acts of 1934 and 1936?

Reasons Relied on for Allowance of Writ.

1.

In deciding that the proceeds received by one as the owner of an oil payment contract, which he had acquired by investment, from the sales of his oil after it is lifted from the earth, must take the basis of ordinary income and cannot be treated as a gain from the sale or exchange of capital assets, the Circuit Court of Appeals resolved, in favor of the Commissioner of Internal Revenue, an important question of Federal income tax law which has never been but ought to be settled by this Court. Petitioner urges that the question is of such importance to the large class of persons who invest their money in oil payment contracts as to merit consideration by the Supreme Court.

2.

The Circuit Court of Appeals held that the decision in this case was ruled by *Burnet* v. *Harmel,* 287 U. S. 103, 77 L. Ed. 199, and *Anderson* v. *Helvering,* 310 U. S. 404, 84 L. Ed. 1277, but petitioner, with all deference, urges that it cannot be so. The present issue was not before the court in those cases and therefore could not have been decided. Nor are general expressions in those opinions conclusive here. Because the consideration of the present issue by the court below was circumscribed by what it erroneously deemed to be the binding force of those cases and because of the importance of a settlement of the question, the Supreme Court should take jurisdiction.

3.

The Circuit Court of Appeals, in deciding that the income in controversy was derived from a "working of the wells" and was not proceeds from a sale or exchange of

property, has restricted the meaning of the words "sale" and "exchange" as used in Section 117 (a) of the Revenue Acts of 1934 and 1936 to an extent never contemplated by the Congress and contrary to the plain meaning as disclosed by the section.

WHEREFORE, petitioner prays that a writ of certiorari issue to the Honorable United States Circuit Court of Appeals for the Fifth Circuit, commanding it to certify to the Supreme Court, for its review and determination on a day certain, a full and complete transcript of the record and proceedings in the cause numbered and entitled on its docket, No. 9586, *Charles Pettit* v. *Commissioner of Internal Revenue*, and that the judgments of the Circuit Court of Appeals and of the Board of Tax Appeals be reversed; and that petitioner have such other and further relief in the premises as this Court may deem proper.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 137

CHARLES PETTIT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

SUPPORTING BRIEF.

To the Honorable, the Supreme Court of the United States:

I.

Opinions of the Courts Below.

The opinion of the Board of Tax Appeals is reported at 41 B. T. A. 264; the opinion of the Circuit Court of Appeals is reported at 118 F. (2d) 816 and appears in the record at page 73.

II.

Jurisdiction.

The opinion of the Circuit Court of Appeals was handed down on March 22, 1941, and the judgment affirming the decision of the Board of Tax Appeals was entered on the same day (R. 76).

Jurisdiction is conferred on the Supreme Court by I. R. C., Section 1141 (a) and 28 U. S. C. A., Section 347. Jurisdiction is invoked on the grounds:

(a) That the Circuit Court of Appeals has decided an important question of Federal Income tax law which has not been but ought to be settled by the Supreme Court;

(b) That the Circuit Court of Appeals has erroneously interpreted the decisions in *Burnet* v. *Harmel,* 287 U. S. 103, 77 L. Ed. 199, and *Anderson* v. *Helvering,* 310 U. S. 404, 84 L. Ed. 1277, as conclusive of the present issue;

(c) That the Circuit Court of Appeals has restricted the meaning of the words "sale" and "exchange" as used in Section 117 (a) of the Revenue Acts of 1934 and 1936, to an extent not intended by the Congress.

III.

Statement of the Case.

The facts set forth in the statement contained in the petition are sufficient for the purposes of the brief, and for the sake of brevity are not repeated here.

IV.

Specifications of Error.

1. The Circuit Court of Appeals erred in overruling petitioner's contention that the income in question was gain realized from the sale or exchange of capital assets, taxable only to the extent of the applicable percentages specified in the capital gains provisions of the Revenue Acts of 1934 and 1936.

2. The Circuit Court of Appeals erred in holding that *Burnet* v. *Harmel* and *Anderson* v. *Helvering* rule the decision of this case.

3. The Circuit Court of Appeals erred in holding that under *Burnet* v. *Harmel* and *Anderson* v. *Helvering*, the income involved in the present case is ordinary income and not gain from the sale or exchange of capital assets.

4. The Circuit Court of Appeals erred in holding that since petitioner did not sell his

> "economic interest in the oil in place, but only particular barrels as lifted, the sale of these barrels under Burnet *v.* Harmel represented not a sale of capital assets but income from the working of the wells."

V.

ARGUMENT.

It seems we were unable to impress the Circuit Court of Appeals with the distinction between petitioner's income and that considered and passed on in prior decisions. The instruments before the court in the present case, while referred to as oil payment contracts, are clearly deeds to oil; they contain provisions substantially as follows:

> "for and in consideration of the sum of $10.00 and other good and valuable consideration * * * granted, sold and conveyed and hereby agrees to deliver unto the buyer if, as and when produced and saved from the aforesaid tracts of land (the specified number of) barrels of merchantable pipe line crude oil" etc.
>
> "This conveyance is intended to have all the effect of a deed to the oil hereby conveyed to the buyer out of (the fractional part) of all the oil produced and saved from the aforesaid leases herein provided, and any pipe line company or other purchasers of oil from said tract shall so treat this agreement and it shall not be necessary for the seller to execute to the buyer any further conveyances or other instruments to enable the buyer to receive full performance hereof" (R. 49).

Although the identical language was not used in all of them (R. 50), neither party to this controversy contends that

there are any differences in substance in this respect in the several contracts (R. 50).

By each of the deeds or contracts, except three,[2] petitioner acquired as an investment a definite quantity of oil, and the deeds provided the method or means of delivery. After it was delivered, petitioner sold it, and he contends that the income he received, which is in question, is proceeds from these sales.

The Circuit Court of Appeals made short work of petitioner's contentions. It said:

> "Nothing daunted by Burnet *v.* Harmel, 287 U. S. 103, the long line of cases following, and the consistent tax practices since, petitioners boldly insisted below, and as boldly insist here, that by these contracts they acquired, as capital assets, a large number of barrels of oil in place; that as particular barrels were lifted and sold, they retained this character, and that the proceeds from the pipe line sales were, therefore, necessarily sales of capital assets."

The court held that the sale of petitioner's "lifted barrels", under *Burnet* v. *Harmel,* represented not a sale of capital assets but "income from the working of the wells"; that there was no basis for distinguishing this case from the *Harmel* case, and that *Anderson* v. *Helvering,* 310 U. S. 404, 84 L. Ed. 1277, which it asserted controlled this case, pointed out the fact.

The generality of language in the opinion of the Circuit Court of Appeals makes it difficult to analyze that decision and to discover wherein it was thought that the *Harmel* and *Anderson* cases rule here. Of course, it is perfectly clear that the present issue was not before the court in

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[2] Exhibit 9 is a "barrel" contract in which petitioner upon the sale of a lease, reserved 210,000 barrels of oil (R. 48). Exhibits 10 and 18 are dollar contracts in which petitioner, upon the sale of his interest in two oil leases, reserved certain amounts of money out of oil (R. 49).

either of those cases, and that if rules were announced in them which are conclusive of the present issue, they must be found in general expressions in the opinions.

The Harmel Case.

In *Burnet* v. *Harmel*, 287 U. S. 103, 77 L. Ed. 199, the only question presented was whether a bonus payment, received by the lessor of an oil and gas lease, was a gain from the sale or exchange of capital assets. We do not understand that the court intended to decide anything except that such bonus payments, like royalty received by the lessor, are rent, to be treated as ordinary income to the lessor, even though the lease may, under the law of the State in which the property is situated, be sufficient also to pass a present title to the oil and gas in place.

In the course of the opinion in that case, these sentences appear: "Oil or gas may or may not be present in the leased premises, and may or may not be found by the lessee. If found, their abstraction from the soil is a time-consuming operation and the payments made by the lessee to the lessor do not normally become payable as the result of a single transaction within the taxable year". The Board of Tax Appeals in the present case thought that the proceeds received and to be received by petitioner are as much of a time-consuming operation as was the income received by Harmel (R. 58). As the Circuit Court of Appeals noted a general agreement with the Board, we assume it took the same view. But they err. Petitioner's position is in no sense that of Harmel's. He is not a lessor; his income does not flow to him as royalty or as rent; it does not come to him as compensation for any use or privilege. Petitioner has granted no right, license or privilege; nothing of his is "used". By the express language of the contracts, they were deeds, conveying to him present titles to oil in

place. *Texas Co.* v. *Daugherty,* 107 Tex. 226, L. R. A. 1917F, 989, 176 S. W. 717; *Stephens County* v. *Mid-Kansas Oil & Gas Co.,* 113 Tex. 160, 29 A. L. R. 566, 254 S. W. 290. His property is oil, and oil alone, and whether stored above or below the ground, remains unqualifiedly his until it is sold. No income arises while it thus remains in storage; there it is idle, stagnant and productive of nothing. The fruition of income from his property is marked by the sale of the property, and from that part which remains unsold, he continues to receive nothing. The realization of income by petitioner from his property is not continuing nor time-consuming. Each parcel of his property, that is, each barrel of his oil, produces income once and only once, and that occurs when it is sold. No part of it gives rise to income more than once, nor until it is sold. Petitioner's situation is like that of one who has bought a quantity of grain in an elevator as a speculation and removes and sells it a lot at a time until the whole is gone. He has invested his capital in oil and the money he receives from the sales represents a return of his capital, plus his profits, if any. The general expression in the *Harmel* opinion concerning a "time-consuming operation" is, therefore, clearly not applicable to petitioner's case.

Other general expressions in the *Harmel* case appear in that portion of the opinion covered by Headnote 2, where the court considered the rule of Texas law which holds that an oil and gas lease conveys to the lessee a present title to oil and gas in place, and particularly the following:

> "Here we are concerned only with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution, to tax income. The exertion of that power is not subject to state control. It is the will of Congress which controls and the expression of its will in legislation, in the absence of language evidencing a different pur-

pose, is to be interpreted so as to give a uniform application to a nation-wide scheme of taxation. * * * State law may control only when the operation of the Federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law. * * * But Section 208 neither says nor implies that the determination of 'gain from the sale or exchange of capital assets' is to be controlled by state law."

There is no specific reference in the record of the present case to this part of the opinion and we do not know what application the Circuit Court of Appeals made of it here, but certainly it does not support the proposition that the oil payment contracts must, for income tax purposes, be construed as mere executory contracts, creating, at most, incorporeal hereditaments in the nature of profits a prendre. The contracts did not create easements nor rights to participate in production of oil, but were conveyances of oil; nor was the oil when lifted, delivered to petitioner in payment or compensation for any thing; petitioner owned it because he had previously bought it and the oil was delivered to him because he owned it.

In the *Harmel* case, the court had a lease before it; it purported to be nothing but a lease. The consideration passing to Harmel was essentially rent, paid to him for the uses, rights and privileges he had granted. The court held that the fact that the lease might be sufficient to convey to the lessee oil and gas in place was immaterial; that it did not alter the fact that actually the office performed by the instrument was to lease, to let. The court did not say, as, of course, it will never say, that it will construe a lease to be a deed, or a deed to be a lease, at its own will and pleasure, either for the purpose of securing uniformity of taxation, or for any other purpose. The court merely construed a certain instrument to be what it clearly purported to be

and to do what it was intended to do. Certainly, it did not say that it would not, for income tax purposes, ever recognize or give effect to State law authorizing the conveyance of oil and gas in place. On the contrary, the rule has always been that where the application of the taxing statute is bound up with property rules, the State law will control. *Poe* v. *Seaborn,* 282 U. S. 101, 110, 75 L. Ed. 239; *Blair* v. *Commissioner,* 300 U. S. 5, 9, 10, 81 L. Ed. 465, 469. And while it is true that within the limits of the 16th Amendment, the will of Congress is supreme, it is also true that Congress has no power to formulate general law or rules of property. *Erie R. Co.* v. *Tompkins,* 304 U. S. 64, 92, 82 L. Ed. 1188. To argue that petitioner's oil payment contracts cannot be considered, for income tax purposes, as vesting him with title to oil in place, is, therefore, to miss the point made in the *Harmel* case and to ignore the express provisions of petitioner's contracts.

Near the end of the opinion in the *Harmel* case, the court said:

> "The court below thought that the bonus payments as distinguished from royalties should be treated as capital gains, apparently because it assumed that the statute authorizes a depletion allowance upon the royalties alone * * * but bonus payments to the lessor have been deemed to be subject to depletion allowances under Section 214a(9), Revenue Act of 1924 and under Article 216, Treasury Regulations 65, as well as under earlier acts. * * * The distinction, so far as we are advised, has not been taken in any other case * * *. We see no basis for it."

The Board of Tax Appeals apparently construed this language as indicating that if income is subject to depletion, it cannot be classed as capital gain (R. 57 and 58). Because of the Circuit Court's general agreement with the Board's decision, we assume it approved this construction.

We find no room in the *Harmel* case for such conclusion. The reduction of income by the use of percentage depletion allowances is purely permissive and optional with the taxpayer; while, if income falls within the definition of capital gain or loss, its treatment as such is mandatory on both the taxpayer and the Commissioner. Section 117 alone is the test to be applied in determining whether income is capital gain or ordinary income; it is perfectly plain that no other section was intended to enlarge or restrict its definitions. The depletion allowances in the case of oil and gas, provided by Sections 23(m) and 114(b) (1) and (3), have reference solely to methods of recovering cost.

The Anderson Case.

In *Anderson* v. *Helvering,* 310 U. S. 404, 84 L. Ed. 1277, Anderson and others, as purchasers, had acquired certain royalty interests, fee interests and deferred oil payments for a fixed sum, payable partly in cash and partly from one-half of the proceeds received by them which might be derived from oil and gas produced from the properties and from the sale of any or all of the lands. The seller was to receive interest on the deferred payments and retained a lien upon one-half of all the oil and gas production and upon the fee interest. The question for decision was whether that portion of the proceeds received from the oil and gas produced, which was to be paid over to the seller under the terms of the agreement, was income to the purchasers. The question of the applicability of the capital gains provisions was not involved and not discussed. However, in discussing the matter of depletion allowances in the case of oil and gas and particularly the case of *Thomas* v. *Perkins,* 301 U. S. 655, 81 L. Ed. 1324, the court took occasion to say:

> "The holder of an oil payment right, as an original proposition, might be regarded as having no capital

> investment in the oil and gas in place. The value of the right, even though dependent upon the extent of the oil reserves, is fixed at the moment of creation and does not vary directly with the severance of the mineral from the soil. In this sense it resembles the right to cash payments more closely than the right to royalty payments. Yet it does depend upon the production of oil, ordinarily can be realized upon only over a period of years, and permits of a simple and convenient allocation between lessor and lessee of both gross income derived from production and the allowances for depletion. Compare Burnet *v.* Harmel, 287 U. S. 103, 106, 107, 77 L. ed. 199, 202, 203, 53 S. Ct. 74. Accordingly, this court in Thomas *v.* Perkins decided that the provision in the lease for payments solely out of oil production should be regarded as a reservation from the granting clause of an amount of oil sufficient to make the agreed payments, and should be given the same tax consequences as a provision for oil royalties."

and we suppose this is the language which the Circuit Court of Appeals relied on when it said that case controlled the present one.

Here is another example of the necessity for the rule that general expressions in an opinion are to be taken in connection with the facts of the case in which they appear and not made to rule different situations. In the *Perkins* case the oil payment contract before the court was a reservation of oil by the seller of oil property, in part payment or as a means of payment of the purchase price. In the *Anderson* case there was merely a lien retained upon a portion of the oil, and upon the fee, to secure the payment of the purchase price. Obviously, if the quoted language is lifted from its setting and applied to a case where the oil payment contracts are of an entirely different character from the kind referred to, it will be made to accomplish a result never intended by the Supreme Court. It would be illogical to assume that the propositions announced in those cases were

intended as tax formulas for every character of oil payment contract. Of course, the court had no intention of suggesting that in no case could the holder of an oil payment, as an original proposition, be considered as having a capital investment in oil and gas in place. The reference was to the particular class of oil payments then before the court, and when the court said that oil payments should take the tax consequences of oil royalties, it is plain that the consequences referred to were the depletion allowances provided by statute in the case of oil and gas. So, it will not do to strike down petitioner's contention that his income is capital gain, upon the claim that it is foreclosed by the *Perkins* and *Anderson* cases.

Our position, that the likeness in tax consequences of oil payments and oil royalties goes no further than the depletion allowances, is fortified by an opinion of the very Circuit Court of Appeals that decided the present case. In *Commissioner of Internal Revenue* v. *Laird*, 91 F. (2d) 498, Judge Hutcheson said for that court:

> "As to the oil payments, we agree with respondent. The Commissioner's argument presses too far the royalty analogy. From the aspect of depletion considered in the above cited cases, respondent's interest as a royalty owner and as the owner of reserved oil payments is the same; that is, as to both, he has an economic interest in the oil in place and as to both, he is entitled to depletion. But there the likeness ceases.
>
> As to the oil payments, respondent is the owner of a certain aggregate capital sum devised to him as such, and all payments received on that account are, until the devised value has been recovered, returns of capital.
>
> As to the royalties, respondent is the owner of a right to receive a rental income from the workings of the leaseholds out of which the royalties issue. All such payments received by him are, in contemplation of Federal income tax law, not receipts of capital, but

of income, by way of rental. In the case of oil payments, until their capital value is received, no question of income arises. By the very nature of the contract for their reservation and payment, each one made diminishes to that extent the capital interest reserved. Their total completely consumes it."

"Working of the Wells."

To say, as the Circuit Court of Appeals said, that petitioner's income arises from the "working of the wells" is to confuse petitioner's property with the evidence of his title. It is the oil that is the property, not the contracts. The contracts are merely the vehicles by which the title passed. The contracts convey oil; they transfer no interest in the wells or in their operation. By them he acquired no license, privilege or right of use. Petitioner's investment is in oil in the reserves. If he sells it in place, his income is from its sale. If he sells it after it is physically delivered to him above ground, his income is likewise from its sale. True, it cannot be physically delivered to him unless the wells are operated, but it does not follow that he has a part in their operation, for the operation of the wells is but an incident in the delivery of the oil. After the oil reaches the surface of the earth, it moves from storage tanks through pipe lines to the purchasers. This, too, is merely an incident of delivery; it would not be contended that petitioner's income arises from the operation of a pipe line. An oil well is nothing more than a pipe line extending up from the oil reserves to the surface of the earth.

The decision that petitioner's income is not derived from sales but from a "working of the wells" is also necessarily bottomed on the proportion that the words "sales" and "exchange" were not used in Section 117 in their ordinary sense, are not broad enough to include every sale and exchange, but mean something considerably less than what they usually indicate.

We have found no suggestion in any of the cases that Congress used the words "sale" and "exchange" in any other than their ordinary sense. There are no qualifying words in the section; nothing in the context requires them to be given less than their literal meaning. Recently the Supreme Court held that the word "sale" was broad enough to include involuntary as well as voluntary sales. *Helvering* v. *Hammel*, Oct. Term, 1940, L. Ed. Ad. Op., No. 5, p. 295. In that case, the court also rejected the contention that a loss upon foreclosure resulted from the decree of foreclosure rather than from the foreclosure sale, saying " * * * the sale was the definitive event establishing the loss within the meaning and for the purpose of the revenue laws. They are designed for application to the practical affairs of men". Likewise, in the present case, the definitive event which brought about the gain was not the running of the oil from the wells or through the pipe lines, but the transfer of title to the oil to the purchasing companies for a consideration.

Conclusion.

We think the decision of the Circuit Court of Appeals in *Carroll* v. *Commissioner of Internal Revenue*, 70 F. (2d) 806 (C. C. A. 5th), points the way to the correct solution of this case. There a partnership owned saw mills and was engaged in the manufacture and sale of lumber at wholesale. It also owned a quantity of growing timber. Under a contract between the partnership and Chester Lumber Company, the Lumber Company had the right to cut the growing timber and pay for it as cut at a specified rate per thousand feet. The taxpayer contended that the income it received from Chester Lumber Company under this contract was taxable under the capital gains provisions of the applicable Revenue Acts. Sustaining this contention, the Cir-

cuit Court of Appeals held that the timber was part of the partnership's assets, was not the kind of property to be included in an inventory of the taxpayer, and that the sale of the timber to Chester Lumber Company was not a part of the partnership's trade or business, and that at the election of the taxpayer, the profits resulting from the sales of the timber under the contract with the Lumber Company were taxable under the capital gains provisions.

Petitioner is convinced that *Burnet* v. *Harmel* and *Anderson* v. *Helvering* do not warrant the construction which the Circuit Court of Appeals has given them. It burdens those opinions with intendments they obviously do not have; it converts them into "Mother Hubbards" covering a variety of situations and questions; it ignores the injunction that " 'general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used' and that if they go 'beyond the case, they may be respected but ought not to control the judgment in a subsequent suit when the very point is presented for decision'." *Wright* v. *United States,* 302 U. S. 583, 593, 82 L. Ed. 439. Clearly the issue here is beyond the scope of those decisions.

We have made diligent search for a case in which the question here presented has been before the Supreme Court, but have found none. Petitioner urges that the question is of such importance that it ought to be settled by the Supreme Court.

Respectfully submitted,

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